

Bill of Lading in the perspective of China laws: a case study

Description

In the year of 2016, a court judgement concerning Letter of Credit dispute handed down by China Supreme Court has caught immense attention from banks, freight forwarders, sea carriers and maritime lawyers.

I. Basic Facts

For a detailed account of the case facts, you can refer to [another post](#) on this blog, but unfortunately, it is in Chinese.

A China bank (CCB) concluded a Trade Finance Facility Contract (together with a few security contracts, personal surety etc.) with a China company "Lanyue" under which CCB, later on, opened a usance letter of credit in the amount of RMB 85.92 million for the latter and on the same day, Lanyue signed over a Trust Receipt to CCB and a deposit pledge agreement as well. According to the Trust Receipt, from the date of the issuance of Trust Receipt, CCB shall acquire the ownership/title in the documents and goods under the letter of credit, and a trust is thus created between CCB and Lanyue whereby CCB is the trust settlor and beneficiary and the Lanyue the trustee. In the meantime, the Deposit Pledge Agreement stipulates that Lanyue shall pay a deposit of RMB 9.81 million as pledge for securing the debts under the letter of credit.

Then Lanyue imported coal into China and failed to repay the money CCB paid under the letter of credit. It shall be noted that CCB didn't release the documents to Lanyue, due to, according to the judgment, the price plunge of coal, fearing the credibility of Lanyue in repaying the loan. Later on it was found that coal was attached by local court in the place where it was stored.

CCB resorted to court to recover its money and among its claims raised to court were: (1) repayment by Lanyue of the loan principal and interest, and (2) affirmation of CCB's title in the goods under the letter of credit and of its preemptive right to be paid out of the disposal income of the goods in priority over other creditors of Lanyue.

The case made its way all up to China Supreme Court after the trial and appellate proceedings in which CCB was denied its ownership claim over the goods and their preemptive right to be repaid in the first place.

II. China Supreme Court Ruling

CCB, in defending its claims, insisted that the bill of lading is the document of title in respect of the goods in dispute and therefore, the possession of the bill of lading itself sufficed for establishing CCB's ownership in the goods.

In addressing the issue of whether CCB had acquired the ownership in the goods, China Supreme Court reasoned:

(1) the question should be broken into two sub-questions: (a) whether a bill of lading is a document representing ownership of goods (the wording is intended to be different from “document of title” in order to reflect China Property Law’s logic), and (b) if the answer to sub-question(a) is yes, then whether the ownership of goods is duly vested in the holder of the bill of lading;

(2) According to the definition of bill of lading in *China Maritime Law*, a bill of lading is the document setting out the rights and obligations of the shipper, carrier and B/L holder, and the B/L holder has the right to request carrier to deliver goods, and in this sense, a bill of lading represents a creditor right. At the same time, in the case of a marine transportation, the owner of the goods does not lose or forsake its ownership in the goods, and as such, the owner shall certainly be entitled to request for restitution of the goods based on its ownership rights, and such ownership-based right of restitution is part of the proprietary claims (this wording may fail you in understanding what I intend to say due to the difficulty in translating property laws). As a bill of lading is the only document underpinning the claim for delivery of goods from carrier, it naturally embodies the ownership-based right of restitution. It is in this sense that a bill of lading is also a document representing ownership. In sum, a bill of lading is a document representing both a creditor’s right and ownership.

Therefore, China Supreme Court found a positive answer to the sub-question (a). Now with regard to sub-question (b), the court continued:

(3) According to Article 79 of China Maritime Law, there are three types of bill of lading: straight, order and bearer, and straight B/L is not transferable, an order B/L can be transferred by endorsement and bearer B/L can be transferred by delivery. In the case of straight B/L, only the consignee appearing on the B/L is entitled to the creditor’s right and ownership represented by the bill of lading, but in the case of transferable B/Ls, whether the holder of the B/L has the ownership in the goods shall be answered in light of its specific situation. The embodiment of creditor right and ownership in a bill of lading is a description of the function and attribute of a B/L. While a carrier can deliver the goods to anyone with the bill of lading, regardless of whether the holder is a legitimate one or not, regardless of how the holder come to hold the B/L, for the holder to lawfully and rightly exercise rights embodied in bill of lading, it shall have a legal basis or ground to do so, in other words, its claims shall be predicated on the existence of certain legal relationship. To illustrate it, the act of delivering the bill of lading could be based on a bailment, or sale of goods, or even on pledge of the bill of lading or the goods thereunder. **Accordingly, in the case of bailment, the bailee while entitled to request carrier to deliver goods is not legal and equitable for him to claim ownership or other proprietary interests in the goods, and in the case of sale of goods, delivering of the bill of lading constitutes the constructive delivery (some people use “indicative delivery” instead referring to the assignment of claim for restitution of goods in lieu of physical delivery of goods that is in the possession of a third party) as provided in Article 26 of China Property Law, thus giving rise to change of ownership in the chattel goods; in the case of B/L pledge, delivering of bill of lading perfects the creation of pledge thereof. So it is concluded that must as the same as in the case of delivery of chattel, what type of proprietary interest that can be acquired by the holder of bill of lading depends on the provisions of underlying contracts.**

(4) then the court went into the specific facts involved in the case finding that there was no provision in related contracts indicating a change of ownership in the goods to CCB in the case of failure by Lanyue in paying off the loan. Though the Trust Receipt provided for transfer of ownership in the goods to CCB upon releasing the documents under L/C, the fact is that CCB didn't give the documents over to Lanyue, therefore, the transfer of ownership didn't take place. Thus, the court ruled that CCB's claim for having ownership in the goods was not warranted.

(5) The court went further to explain that the Trust Receipt, in light of its contents, was intended to create a security with the transfer of ownership in the goods to CCB, but this is against China security laws and therefore null and void.

However, the court managed to find in favor of CCB from some ambiguous provisions to the effect that CCB shall have the right to dispose of the documents and/or the goods and create additional security (without specifying what kind of securities) thereon, that CCB by keeping the bill of lading in its hands had created a lawful B/L pledge in accordance with China Property Law, and consequently, CCB shall have the priority right to be paid out of the disposal income of the goods.

In arriving at the decision of affirming CCB's B/L pledge, the court mentioned that:

The basic mechanism and customary practice of a letter of credit is that the issuing bank holds the L/C till the payment of the applicant and if the applicant fails to pay, the issuing bank will not release the documents, and it is clear that the purpose of holding bill of lading by the issuing bank is to securing its realization of its creditor right. As stated above, the issuing bank does not enjoy the ownership in the goods under the B/L, and any failure to recognize its security interests in the bill of lading or the goods thereunder will run squarely against the customary practice of "paying for the documents" and the basic mechanism of documentary credit, and against the intention and purpose of the parties to documentary credit to collateralize the documents (including bill of lading) under L/C in favor of the issuing bank.

III. Comments on the Ruling

(1) Nature of Bill of Lading

This new ruling from China Supreme Court is making waves in the trade finance and legal industries as it touched on quite a few hotly debated topics that have been controversial in both academic and practice arenas.

In the past, it was a very popular view that a bill of lading represents ownership in the goods, and thus possession of B/L entitles the possessor to claim ownership in the goods thereunder, as was put forward by CCB in the case but was definitely wrong.

I am not 100% for the opinions and reasoning put forward in the judgment. The logic for finding bill of lading embodying ownership above is not well grounded but broken indeed. It is my personal opinion that the right to claim delivery by a holder of bill of lading has nothing to do with the ownership in the

goods, it is simply a contractual right under the carriage contract indicated in the bill of lading itself. The ownership issue is to be governed and determined pursuant to the sale contract of the goods only, and this is clearly affirmed by the China Supreme Court judgment.

One cannot help wondering what it really means and what purpose it can serve to find the bill of lading embodying ownership in the goods when the ownership of goods is exclusively determined by the sale contract.

(2) Trust Receipt

A TR finance is popular in the common law countries. It is borrowed into China trade finance practice for years hoping to create the same effect as it does in the west, namely, retaining ownership in the goods when releasing documents to L/C applicant. Unfortunately, the attempt is basically unsuccessful so far.

As pointed out in the ruling, the purpose of Trust Receipt is interpreted as creating a security interest with the ownership transferred to the creditor, but this is against Chinese law. Banks offering trade finance shall have to reconsider their TR practice.

It remains to be seen in the future how China issuing banks can find a valid way to retain a lawful security interests in the goods after releasing the documents to the L/C applicants.

On the other hand, it is clear that L/C issuing banks do have a pledge right over the bill of lading so long as this security interest is clearly stipulated in relevant lending contract or security arrangement.

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